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VIA FEDERAL EXPRESS

June 23, 1999

Magalie Roman Salas, Esq.
Secretary
Federal Communications Commission
445 Twelfth Street, SW Suite TWA-325
Washington, DC 20554

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FCC MAIL ROOM

RE: *Clarification of the Commission's Rules on Interconnection Between LECs and Paging Carriers, CCB/CPD No. 97-24 ("SWBT clarification request")*

Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, First Report & Order, CC Docket Nos. 96-98, 95-185 ("interconnection reconsideration order")

Formal Complaint of Metrocall against Various LECs, File Nos. E-98-14-18

Formal Complaint of USA Mobile Communications, Inc. II against CenturyTel of Ohio, Inc., File No. E-98-38

Formal Complaint of Arch Communications Group, Inc. against U S WEST Communications, Inc., File No. E-99-05

Formal Complaint of Arch Communications Group, Inc. against BellSouth Telecommunications, Inc., File No. E-99-06

Notice of Ex Parte Presentation

Dear Ms. Salas:


On June 23, 1999, Angela E. Giancarlo and Mary McDermott of the Personal Communications Industry Association together with Michael L. Katz of the Tilden Group and Carl W. Northrop of Paul Hastings Janofsky & Walker LLP met with the following FCC staff members: Patrick deGraba, David Konuch, and Ed Krachmer of the Common Carrier Bureau and Julie Buchanan, Dan Grosch, Jim Schlichting and Peter Wolfe of the Wireless Telecommunications Bureau.

I have enclosed a copy of *ex parte* presentation materials reviewed and discussed at the meeting. They are: (1) *Economically Rational Interconnection: Reciprocal Compensation for Paging Carriers*; and (2) *The Interconnection of One-Way Messaging Networks and the Public Switched Telephone Network* (June 1999 version). These presentations cover issues related to the above-referenced proceedings.

Pursuant to §1.1206(b) of the Commission's rules, two copies of this letter for each of the above-referenced dockets are hereby filed with the Secretary's office.

Kindly refer questions in connection with this matter to me at 703-535-7487.

Respectfully submitted,


Angela E. Giancarlo, Esq.
Director, Federal Regulatory Affairs

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Economically Rational Interconnection: Reciprocal Compensation for Paging Carriers

Michael L. Katz

23 June 1999

INTRODUCTION

- ▽ Paging carriers incur costs terminating calls that originate on LEC networks and that create value for LECs and their customers.
- ▽ Even if one believes the interconnection regime needs reform, Haring and Rohlf's proposal does not provide a useful starting point.

SPECIFIC ISSUES

- ▽ Should paging carriers be compensated for the transport and termination of LEC-originated local traffic?
- ▽ Should LECs be allowed to charge paging providers for interconnection facilities?
- ▽ Should the Commission take a lead in establishing federal rules governing reciprocal compensation?

AGENDA

1. Review Legal Environment
2. Review Economics of Bargaining
3. Debunk Specious Arguments
4. Discuss the Value of Federalism
5. Summary

LEGAL ENVIRONMENT

- ▽ Paging providers are:
 - CMRS providers.
 - telecommunications carriers.
- ▽ Paging providers are entitled to compensation for LEC-originated local traffic:
 - termination.
 - transport.

THE RULES

“The additional costs of transport and termination for local calls.”

- ▽ *Additional Costs*: average long-run incremental cost.
- ▽ *Transport*: Traffic from the last point of the LECs' network to the equivalent of a wireline end office switch.
- ▽ *Termination*: traffic from the equivalent of a wireline end office switch out to CPE.
- ▽ *Local*: Traffic originating and terminating within the same MTA.

DO THE RULES MATTER?

- ▽ A question only an economist would ask.
- ▽ The rules can determine financial transfers.
- ▽ More important--from a public interest perspective--the rules can have real effects:
 - Investment levels.
 - Network configurations.
 - Consumption decisions.

THE ECONOMICS OF BARGAINING

- ▽ Threat points matter.
- ▽ There are incentives to reach agreements that maximize the total well being of the bargaining parties.
 - In the absence of obstacles, the bargaining outcome will be efficient.
 - There can be distortions due to the exercise of market power.

IMPLICATIONS

- ▽ ILECs have much stronger bargaining positions: they can survive without interconnection to paging carriers.
 - Clear from historical experience.
- ▽ ILECs lack information to discriminate perfectly and thus will exercise market power in inefficient ways:
 - Reduce incentives to invest in paging.
 - Increase paging service prices.
- ▽ The choice of interconnection facilities is much more likely to be efficient (subject to the imposition of quality standards).
 - Cost-minimization incentives are strong.

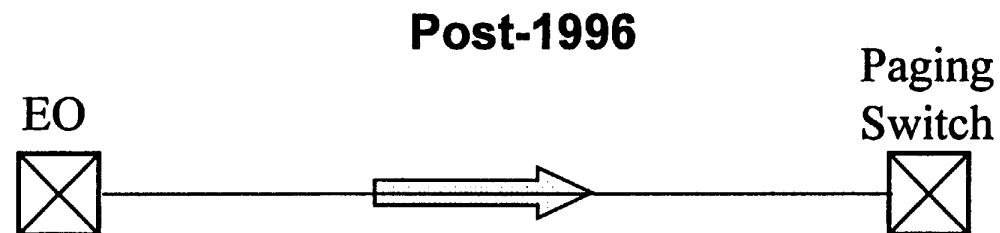
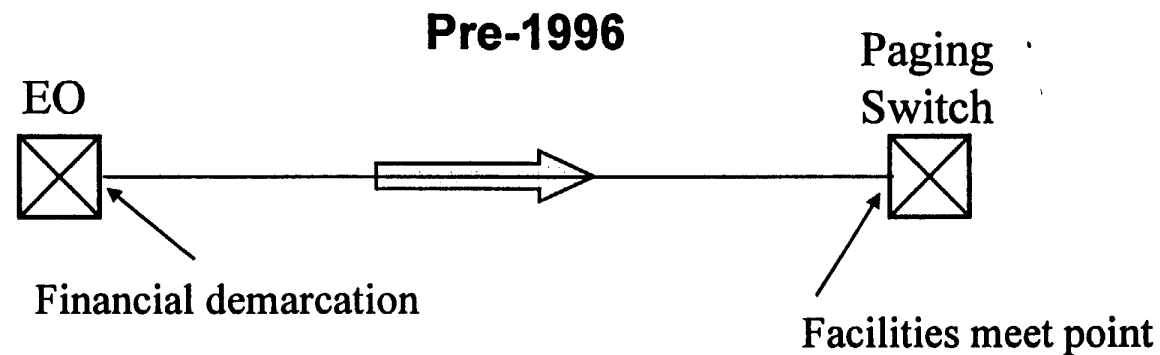
BENEFITS OF THE RIGHT RULES

- ▽ The rules can create threat points with a more even balance of bargaining power.
- ▽ What are the real effects?
 - Efficient investment is promoted if the rules allow providers of valuable services to recover their costs.
 - Efficient consumption decisions are promoted if end users face cost-based prices when making subscription and calling decisions.
- ▽ Markets work only if property rights are defined and enforced.

GETTING INTERCONNECTION RIGHT IS AN EXTREMELY DIFFICULT PROBLEM

- ▽ The reciprocal compensation scheme should reflect both costs and benefits of traffic exchange, as well as the administrative costs of the program.
- ▽ This is complex because, when a paging call is completed, both the originating LEC and the terminating paging provider:
 - Have customers who benefit.
 - Themselves benefit.
 - Themselves incur costs.

A SIMPLE SCHEMATIC OF INTERCONNECTION



SPECIOUS ARGUMENTS FOR DENYING COMPENSATION TO PAGING CARRIERS

- ▽ Substitutes v. complements distinction.
- ▽ Lack of directory listings.
- ▽ Traffic imbalance.

SUBSTITUTES v. COMPLEMENTS

- ▽ This is not a useful distinction for determining compensation.
 - If anything, it makes more sense to promote complements than substitutes.
 - Paging creates value for LECs.
- ▽ Paging services do provide a substitute means of reaching a given end user.
 - Example: paging a child v. making a pre-arranged call.
 - Example: e-mail to a pager rather than to a PC using a dial up modem.

BROADER PROBLEMS WITH THE HARING-ROHLFS ANALYSIS

- ▽ Haring and Rohlfs falsely conclude that what matters is how the *originating* carrier's costs change, rather than how the *terminating* carrier's costs change.
 - Value to a LEC comes not just from cost reduction, but also from quality improvement.
- ▽ They incorrectly assert that the called party is “the” cost causer.
 - If one *had* to choose, calling party is the one who causes costs.
 - In fact, both calling and called parties must take actions to complete a call and both typically enjoy benefits from a call.

BENEFITS TO LECS

- ▽ Form of termination that substitutes for LEC termination.
- ▽ Raises the value of local exchange service.
- ▽ Often generates a return call.
 - If pay phone or LMS customer, call directly generates incremental revenues.
 - If a flat-rated customer, call reflects increased value of local exchange service.

DIRECTORY LISTINGS

- ▽ Factually inaccurate to assert that lack of directory listings sets paging apart.
 - Paging numbers are listed in the yellow pages and on letterhead and business cards.
 - Residential primary numbers and second lines, direct dial business numbers, and cellular and PCS numbers are often unlisted.
- ▽ Cellular and PCS subject to reciprocal compensation, the possible lack of directory listings notwithstanding.
- ▽ Economically meaningless.
 - Should reciprocal compensation be denied for unlisted numbers? What about people who use caller ID? Who use answering machines to screen calls? And how about people who are rude to unsolicited callers?
 - If anything, the lack of listing reduces LEC network congestion.

TRAFFIC IMBALANCE

- ▽ The degree of traffic balance is irrelevant except for the argument that rates don't have to track costs precisely when traffic is close to balanced.
- ▽ In a setting where traffic flows were weighted toward them, ILECs argued that imbalance was a reason to implement compensation rather than rely on bill and keep.

PIECEMEAL REFORM CAN CREATE PROBLEMS

- ▽ ILECs successfully fought bill and keep for other CMRS. If they can selectively choose it, cross-carrier distortions will be created.
- ▽ Piecemeal reform generally can create opportunities for carriers to “game” the system.

FACILITIES CHARGES ARE INAPPROPRIATE

- ▽ LECs and paging carriers have incentives for efficient network configurations.
- ▽ Facilities charges would raise the following possibility:
 - A paging carrier would charge a LEC for transport where the paging carrier was using LEC facilities to provide the transport services to the LEC.

VALUE OF COMMISSION LEADERSHIP

- ▽ Paging carriers and services often cross state boundaries.
- ▽ There can be economies of scope in policy design and compliance.
- ▽ There are jurisdictional externalities.
 - Decisions in one state can affect providers and users in other states.

SUMMARY

- ▽ Paging carriers should be compensated for the transport and termination of LEC-originated local traffic.
 - The arguments made against it are fatally flawed.
- ▽ LECs should not be allowed to charge paging providers for interconnection facilities used to deliver LEC-originated local traffic to the paging providers.
 - There are economic incentives for efficiency under the current system.
- ▽ The Commission should take the lead in establishing federal rules governing reciprocal compensation.
 - There are social and private benefits from a federal framework.